

No protest 5-14-92

Internal Revenue Service
District Director

Department of the Treasury

P. O. Box 2508
Cincinnati, OH 45201

Date: MAR 27 1992

Employer Identification Number:

Person to Contact:

Telephone Number:

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(7) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. A determination has also been made as to whether or not you qualify for exemption from Federal income tax under the provisions of section 501(c)(3) of the Code. Based on the available information, we have determined that you do not qualify for exemption under either of these sections of the Code for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code and we have concluded that you do not.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1120.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe that it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues". The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the

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Regional Office, or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

If we do not hear from you within the time specified, this will become our final determination.

Sincerely yours,

[REDACTED]
District Director

Enclosures: 3

cc: [REDACTED]

Enclosure I
Reasons for proposed denial of exempt status

EIN: [REDACTED]

On your application you stated that you operated as an unincorporated polka dancing club several years before you decided to incorporate and that your activities are and will continue to be the same as before incorporation. Information submitted indicates that you were incorporated [REDACTED], in the State of [REDACTED]. Your Articles of Incorporation state that your purposes are:

To establish, maintain and manage a social club for the promotion, fostering and encouraging of polka music and dancing.

To conduct and participate in private and public parties, dances and festivals.

To preserve the culture and tradition of folk dance and music and to promote fellowship among those having a common interest therein.

Your By-Laws provide that your first members would consist of the members of the original Board of Directors, unless they had resigned or their membership was otherwise terminated. Thereafter, the eligibility and qualifications for membership and the manner of admission into membership shall be prescribed by resolutions adopted by your Board of Directors or by such rules and regulations as may be prescribed by your Board of Directors. Your affairs shall be managed by your Board of Directors. Your By-Laws state that Directors do not need to be members of your organization or residents of the state of your incorporation and that the number of Directors shall be three. The Board shall consist of all officers along with such other Director positions as determined by the membership at their annual meeting. Any vacancy on the Board may be filled by a majority vote of the remaining Directors, even if less than a quorum (50 percent) of the Board. Your By-Laws provide that your officers shall consist of a president, vice-president, secretary, and treasurer and that any two or more offices may be held by the same person except the offices of president and secretary.

Your Articles of Incorporation name [REDACTED] and [REDACTED] as your incorporators. On your application you listed [REDACTED] as president, [REDACTED] as secretary, and [REDACTED] as director. Your Board of Directors consist of [REDACTED], [REDACTED], and [REDACTED]. [REDACTED] is the daughter of [REDACTED] of [REDACTED] (hereinafter [REDACTED]). The members of your Board of Directors are not listed as voting members of your organization.

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[REDACTED]
EIN: [REDACTED]

On your application you stated that your purpose is to organize people that enjoy polka music, whether it be a certain band, a certain ethnic style or just to promote it. Each year your primary project is the [REDACTED] in [REDACTED] which is sponsored by [REDACTED]. The dates the festival is held is determined by [REDACTED]. The festival is normally held for [REDACTED] days in [REDACTED]. You participated in the festivals held [REDACTED], and [REDACTED]. The [REDACTED] festival is scheduled to take place [REDACTED]. Admission charges are determined by [REDACTED] and are \$[REDACTED] per person ages 20 and up, \$[REDACTED] per person ages 13 through 19, and free for ages 12 and under when accompanied by a parent. You stated that your members sell admission tickets to the festivals and that admission tickets are sold both in advance and at the door. Activities at the festival consist of dancing to polka, country swing, 50's 60's Groups, polka dance contest, dance lessons, and church services. The festival is open to the general public.

You enter into an agreement with [REDACTED], doing business as [REDACTED] Fest, whereby you agree to assist in set up, take down, sale of admission tickets, beverage ticket sales, parking attendants, and beverage dispensing. The agreement for [REDACTED] states that for each shift worked, a member shall receive a 5-day festival pass at no charge. One shift will be considered 4-5 1/2 hours in length. You are liable for obtaining the liquor license for the festival. [REDACTED] obtains general liability, worker liability and liquor liability insurances naming you as an additional insured. You are invoiced for this cost or a percentage of this cost. You are invoiced for additional costs such as beer pitchers, cups, ice, coolers, a percentage of the rental of tents, floors, tables and chairs plus park, administrative costs and the beverage supervisor's wages. In return for your agreement with [REDACTED] you receive the profits from the sale of beverages. [REDACTED] keeps track of supplies used during the course of the festival and also the hours your volunteers contribute. If the hours contributed are less than the free passes given, you are billed for the passes. You submit daily reports to [REDACTED]. You stated that your main responsibility is to promote a friendly, family environment, both for the patrons and your members and for the betterment of polka music. [REDACTED] is your main and only activity.

In a letter dated [REDACTED], you stated that you solicit for members by advertisement and ticket sales. In a letter dated [REDACTED], you stated that you do not solicit for members by advertisement and ticket sales and that membership is solicited by word of mouth. In a letter dated [REDACTED], you stated that your only requirement for membership is to fill out an application

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which can be obtained by asking a current member for an application. You stated that the general public is allowed to attend the [REDACTED] through the purchase of an admission ticket and are more than welcome to become members of your organization by filling out an application for membership. You also stated that your present members are soliciting for new members at the festival. Your membership application requests the name, address, and phone number of the individual and states that you are a nonprofit organization and that you are organized to promote the well being of polka music.

In a letter dated [REDACTED], you stated that you had [REDACTED] members. As of [REDACTED], you stated you had [REDACTED] members. The only records you maintain on members is the completed membership application and a mailing list. You do not charge membership dues. You stated that membership entitles each member to assist in the promotion of polka music, members may be entitled to discounted ticket prices on other events, and a member who helps at the festival will be allowed a 5-day free entry pass for each shift worked.

In a letter dated [REDACTED], you stated you have not sponsored any social and recreational activities of your own. We requested a description of the specific activities you conduct in order to promote, foster, and encourage polka music and dancing. You responded that you help with the set up, tear down, admission and beverage ticket sales, dance contest, and support the entertaining groups in connection with [REDACTED]. You do not have a clubhouse or any facilities of your own.

Article III of your articles of incorporation provide that you would be financed by donations and revenue from admissions and sales of food and beverage at dances, parties and festivals. In a letter dated [REDACTED], you stated that your sole revenue generating item is the sale of beverages at [REDACTED]. You reported beverage sales of \$[REDACTED] for the year ended [REDACTED], and \$[REDACTED] for the year ended [REDACTED]. Funds are expended for purchasing beverages, the beverage supervisor's wages, security, concessionaire rental, liquor liability, general liability and worker liability insurances, beverage supplies, sales tax, legal and accounting expenses, and office expenses. You donated \$[REDACTED] and \$[REDACTED] to the City of [REDACTED] in [REDACTED] and [REDACTED], respectively.

We asked what recordkeeping procedures you have in place in order to keep track of income received from people who are not members of your organization. On [REDACTED], you responded that at the present time, you reconcile beverage tickets sold to cash receipts and that no distinction is made between sales to members and nonmembers. You destroy the tickets after reconciliation.

EIN: [REDACTED]

You initially applied for exemption under section 501(c)(3) of the Code.

Section 501(c)(3) of the Code provides, in part, for the exemption from Federal income tax of organizations organized and operated exclusively for charitable, religious or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Regulations states that in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i) of the Regulations states that an organization is organized exclusively for one or more exempt purposes only if its articles of organization:

- (a) Limit the purposes of such organization to one or more exempt purposes; and
- (b) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(b)(1)(ii) of the Regulations states that in meeting the organizational test, the organization's purposes, as stated in its articles, may be as broad as, or more specific than, the purposes stated in section 501(c)(3).

Section 1.501(c)(3)-1(b)(1)(iii) of the Regulations states that an organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it to carry on, otherwise than as an insubstantial part of its activities, activities which are not in furtherance of one or more exempt purposes, even though such organization is, by the terms of such articles, created for a purpose that is no broader than the purposes specified in section 501(c)(3).

Section 1.501(c)(3)-1(b)(1)(iv) of the Regulations states that in no case shall an organization be considered to be organized exclusively for one or more exempt purposes, if, by the terms of its articles, the purposes for which such organization is created are broader than the purposes specified in section 501(c)(3).

EIN: [REDACTED]

Section 1.501(c)(3)-1(c)(1) of the Regulations states that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

The presence of a single noncharitable or noneducational purpose, if substantial in nature, will preclude exemption under section 501(c)(3) of the Code regardless of the number or importance of truly charitable or educational purposes. See Better Business Bureau v. U.S., 326 U.S. 279 (1945), Ct.D 1650, C.B. 1945, 375.

You do not meet the organizational test because your Articles of Incorporation do not limit your purposes to the purposes specified in section 501(c)(3) of the Code. The operation of a social club is not a section 501(c)(3) purpose.

You do not meet the operational test because you are not engaged in any activities which accomplish section 501(c)(3) purposes.

Accordingly, we have concluded that you do not qualify for exemption from Federal income tax under section 501(c)(3) of the Code and contributions to you are not deductible by donors under section 170 of the Code because you do not meet the organizational and operational tests.

We informed you that we did not believe you were described in section 501(c)(3) of the Code and suggested that you may more clearly qualify for exemption as an organization described in section 501(c)(7) of the Code because your Articles of Incorporation stated that you were a social club. You agreed and re-applied for exemption under section 501(c)(7) of the Code.

Section 501(c)(7) of the Code provides for the exemption from Federal income tax of clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Section 1.501(c)(7)-1(a) of the Regulations states that the exemption provided by section 501(a) of the Code for an organization described in section 501(c)(7) of the Code applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, but does not apply to any club if any part of its

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net earnings inure to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.

Section 1.501(c)(7)-1(b) of the Regulations states that a club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, timber, or other products, is not organized and operated exclusively for pleasure, recreation and other nonprofitable purposes, and is not exempt under section 501(a) of the Code.

In Keystone Automobile Club v. Commissioner, 181 F.2d 402 (1950), Allied Trades Club v. Commissioner, 228 F.2d 906 (1956), Chattanooga Automobile Club v. Commissioner, 182 F.2d 551 (1950), and Automobile Club of St. Paul v. Commissioner, 12 T.C. 1152 (1949), nonprofit automobile clubs were not recognized exempt under section 501(c)(7) of the Code on the ground that rendering commercial services to members at a lower cost than they otherwise would have to pay was not an exempt purpose contemplated by the statute. Other factors taken into account by the courts were failure of members to commingle, commercial methods of soliciting new members, and lack of social facilities.

Revenue Procedure 71-17, 1971-1 C.B. 683, modified by Public Law 94-568, 1976-2 C.B. 596, sets forth limitations on the extent to which nonmembers may use a club's facilities and participate in activities which it sponsors. The Committee Reports accompanying Public Law 94-568 (Senate Report No. 94-1318, 94th Congress, 2d Session, 1976-2 C.B. 597) provide that a social club may receive up to 35 percent of its gross receipts, including investment income from sources outside its membership without losing exemption, provided that not more than 15 percent of gross receipts are derived from nonmember use of club facilities or services. The Reports indicate that it is not intended that clubs be permitted to receive, within the 15 percent or 35 percent allowances, income from the active conduct of businesses not traditionally carried on by social clubs, regardless of whether the income is from members, nonmembers, or both. The Reports also indicate that it is intended that any organization exempt under section 501(c)(7) of the Code, may receive the full 35-percent amount of its gross receipts from investment income sources (reduced by any amount of nonmember income). This means that a national organization of a college fraternity or sorority that has no outside income from permitting the general public to use its facilities may receive investment income up to the full 35-percent amount of its gross receipts. On the other hand, in the case where a social club permits

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nonmembers to use its club facilities and receives 15 percent of its gross receipts from these nonmember sources, it may receive only up to 20 percent of its gross receipts from investment income. Gross receipts are defined in the Committee Reports for this purpose as:

...those receipts from normal and usual activities of the club (that is, those activities they have traditionally conducted) including charges, admissions, membership fees, dues, assessments, investment income (such as dividends, rents, and similar receipts, and normal recurring capital gains on investments, but excluding initiation fees and capital contributions.

Revenue Ruling 55-716, 1955-2 C.B. 263 held that the term "club" as used in section 501(c)(7) of the Code contemplates the commingling of members, one with the other, in fellowship. Personal contacts and fellowship must also play a material part in the life of an organization in order for it to come within the meaning of the term "club". In this revenue ruling, the organization was held not exempt under section 501(c)(7) of the Code because fellowship did not constitute a material part of the life of the organization since the activities it was engaged in did not afford an opportunity for personal contacts and fellowship among members.

Revenue Ruling 56-475, 1956-2 C.B. 308 denied exemption to an organization which conducted irregular meetings of members and occasional social activities. Its primary activity was conducting stock car racing events in which only those members who owned stock cars participated. Such events were open to the general public upon payment of admission fees. The income realized on these racing events constituted a major portion of the organization's gross receipts. Inasmuch as the organization conducted annually a number of public stock car racing events from which it received a large part of its total revenue, which it used to defray expenses and to pay prizes to its members who take part in the racing events, it was held that the organization was engaged in business with the public for profit and was not organized and operated exclusively for pleasure, recreation or social purposes.

Revenue Ruling 58-588, 1958-2 C.B. 265 held that an organization whose predominant activity is the selling of services for profit to an unlimited number of so-called "members", who have no voice in the management of the club and whose only rights are to the use of the club's facilities upon the payment of specified fees, is not a tax-exempt social club within the meaning of section 501(c)(7) of the Code. It was determined that the club was operated in the personal interest of a few individuals, that social features were not a material

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purpose of the club but were subordinate and merely incidental to the active furtherance of a predominant purpose to engage in the business of selling services for profit to an unlimited number of individuals termed "associate members", that "associate" membership is not a true membership but is merely a guise under which virtually unlimited numbers of individuals may utilize the club facilities, and that income from associate members is in reality income from transactions with the general public.

Revenue Ruling 58-589, 1958-2 C.B. 266 provides in determining whether an organization qualifies for exemption under section 501(c)(7) of the Code, there must be an established membership of individuals, personal contacts and fellowship. A commingling of the members must play a material part in the life of the organization. This revenue ruling also provides that in order to retain exemption a club must not enter into outside activities with the purpose of deriving profit. If such income producing activities are other than incidental, trivial or nonrecurrent, it will be considered that they are designed to produce income and will defeat exemption.

Pursuant to the above facts and law, you do not have any organized social and recreational activities and you are not organized for pleasure, recreation, and other nonprofitable purposes. In a letter dated [REDACTED], you stated that members must request to be a board director then the membership votes on them. You also stated that each member is entitled to one vote. These statements conflict with your By-Laws which provide that Directors do not have to be members of your organization. It is also noted that none of your current directors or officers are listed as voting members of your organization. It is our opinion that your so-called "members" have no voice in the management of this organization. Your dealings with the general public in regards to the festival indicate that you are dealing with the public. You realize a profit on the festival beverage sales in which you participated during the two year period ended [REDACTED]. There is no evidence of commingling among your so-called "members". Personal contact and fellowship does not play a material part in your organization's activities. You solicit for new members at a public event which is advertised to the general public and you have no social facilities. Pursuant to Revenue Ruling 55-716, it is our opinion that you are not a "club" as that term is used in section 501(c)(7) of the Code.

It is our opinion that your activities constitute dealing with the general public and all of your income constitutes income from sales to the general public. As stated above, Revenue Procedure 71-17, modified by Public Law 94-568, provides that in the case where a social club

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permits nonmembers to use its club facilities, receipts from these nonmember sources may not exceed 15 percent of gross receipts. The income you receive from beverage sales at the festivals constitute nonmember income and these amounts exceed the 15 percent limitation as allowed by Rev. Proc 71-17 and Public Law 94-568.

The organization and operation of a club in a manner which constitutes a subterfuge for doing business with the public is inconsistent with the term "club" as used in section 501(c)(7) of the Code and disqualifies it from exemption. Due to the intermingling of your functions and operations with [REDACTED] as discussed above, it is our opinion that your manner of operation constitutes a subterfuge for doing business with the public. Accordingly, you are not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes and you do not qualify for exemption from Federal income tax under section 501(c)(7) of the Code.